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ARIZONA CORPORATION COMMISSION

May 9, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Dingell:

On behalf of Chairman Kunasek, transmitted herewith are the responses of the Arizona Corporation Commission to the questions contained in your letter dated April 10, 1997. As indicated thereon, we are actively involved in identifying and analyzing the myriad of issues surrounding the introduction of competition in generation into the retail electricity markets in the State of Arizona.

At this point, several of the answers are incomplete, reflecting the fact that much work remains to be accomplished prior to the scheduled January 1, 1999 date for the commencement of competition in Arizona.

Should you or your office desire clarification of the attached information or require any further data, please feel free to contact me at (602) 542-0745.

Sincerely,

Carl W. Dabelstein, Director
Utilities Division

c.c. The Commissioners

U.S. HOUSE OF REPRESENTATIVES
SURVEY ON ELECTRICITY RESTRUCTURING ISSUES
RESPONSE OF THE ARIZONA CORPORATION COMMISSION

1. *Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?*

The Arizona Corporation Commission adopted Retail Electric Competition Rules on December 26, 1996 in Order No. 59943 (Docket No. U-0000-94-165). The rules lay out a mechanism whereby retail electric competition will be phased in, starting in 1999. On January 1, 1999, the first 20% of the market will be opened to retail competition. Then, a second phase, starting on January 1, 2001, will allow 50% of the market choice and full competition will commence on January 1, 2003.

The rules ensure that all customer classes will be allowed access to each of the competitive phases. Utilities are required to file Unbundled Services tariffs and Standard Offer tariffs by December 31, 1997. Six working Groups have been established to work out the details of implementing of the rules. Most of the Working Groups will report back to the Commission this fall.

The Arizona Legislature has established a Joint Legislative Study Committee on Electric Industry Competition. The Study Committee's report is due at the end of 1997.

2. *Has your State asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action?*

Arizona has made no direct requests. However, Governor Symington sponsored a resolution which was adopted by the Western Governors Association in February 1997 which asked Congress not to adopt a "one size fits all" approach to deregulation.

The Arizona Corporation Commission has kept the Arizona Congressional deregulation informed about progress here in Arizona on retail competition.

3. *Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?*

Yes, assuming the recovery mechanism does not violate state constitutional limitations, for example, the prohibition against taxation on behalf of a public service corporation, A.R.S. Const. Art. 9 sec 10, or constitutional prohibition against special legislation, A.R.S. Const. Art. 2, Pt.2 sec. 13.

4. *Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978?*

No.

5. *Would any constitutional issues be raised by federal legislation:*
- a. *mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition*
 - b. *requiring states to conduct a proceeding on retail competition, reserving to the states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interest?*

The usual tenth amendment issues would possibly be raised under the holding of *New York v. United States*, 505 U.S. 144 (1992) (federal requirement that state regulate low-level nuclear waste in accordance with federal mandate violated tenth amendment). A possibility that a state could “opt out” of national commerce in electric energy may create a commerce clause issue, even if it is sanctioned by Congress. An “opt out” provision would cause the incumbents to redouble their efforts to obtain an “opt out” from the state, and to press their arguments to the state judiciary that they are entitled to exclusive service territories. In addition, there would be the state constitutional problems alluded to in answer to question 3.

6. *From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?*

The question is difficult to answer because it is not plain what sort of legislation the Congress has in mind, nor is it obvious what kind of “grandfathering” of state action is contemplated. It is hoped that Congressional action would not be so detailed as to cause needless revamping of state efforts to foster competition. Business decisions based on state rules for competition that might be imprudent as a result of conflicting Federal action could create extreme financial hardships.

7. *In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interests of small and residential consumers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the evidence of such rate reductions is on the increase.*
- a. *Are you aware of any study or analysis relevant to your State that supports this conclusion?*
 - b. *Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.*
- a. No.
 - b. See answer to question number 8.

8. *Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your State, and how they affect various customer classes.*

Historical rates and trends are provided below for retail distributors regulated by the Commission and for the Salt River Project, a municipality which is not regulated by the Commission. Rates are in constant 1992 dollars. Market shares are percentages of total sales for each class for all distributors listed.

UTILITIES	1990	1991	1992	1993	1994	1995	CONSUMER GROWTH %
Arizona Public Service Co							
Residential ¢/kWh	10.76	10.40	10.31	10.07	9.37	9.14	-3.22
Commercial ¢/kWh	9.34	8.96	8.83	8.68	8.09	7.81	-3.52
Industrial ¢/kWh	6.40	6.11	5.99	5.86	5.43	4.97	-4.92
Residential Share %	39.0	38.9	38.8	38.8	39.1	39.3	
Commercial Share %	53.8	54.3	53.8	53.7	53.7	53.9	
Industrial Share %	26.1	26.4	25.3	25.3	24.8	23.4	
Tucson Electric Power Co							
Residential ¢/kWh	88.8	9.25	8.98	8.83	8.84	8.71	-0.37
Commercial ¢/kWh	10.46	10.87	10.63	10.43	10.30	10.11	-0.69
Industrial ¢/kWh	6.69	6.93	6.51	6.25	6.14	5.99	-2.19
Residential Share %	14.0	13.8	13.7	13.8	13.5	13.4	
Commercial Share %	9.7	9.4	9.3	9.4	9.1	8.8	
Industrial Share %	25.8	25.5	25.1	25.6	26.1	24.9	
Citizens Utility Co.							
Residential ¢/kWh	9.15	8.79	8.65	8.64	8.49	8.14	-2.33
Commercial ¢/kWh	10.18	9.79	9.57	9.46	9.02	8.78	-2.91
Industrial ¢/kWh	9.60	9.11	9.03	8.82	8.11	7.66	-4.42
Residential Share %	2.1	2.3	2.4	2.4	2.5	2.5	
Commercial Share %	1.9	1.9	2.1	2.1	2.0		
Industrial Share %	0.9	1.0	1.0	1.0	1.1	1.2	
AEPCO Distribution Cooperatives							
Duncan Valley Electric Coop							
Residential ¢/kWh	9.85	8.21	8.17	7.90	7.10	7.10	-6.34
Commercial ¢/kWh	9.31	8.11	7.58	7.23	7.13	7.30	-4.74
Industrial ¢/kWh	4.66	4.11	3.86	4.05	3.92	3.43	-5.93
Residential Share %	0.01	0.01	0.01	0.01	0.01	0.01	
Commercial Share %	0.0	0.0	0.0	0.0	0.0		
Industrial Share %	8.6	9.8	10.9	10.3	10.3	10.3	11.5
Graham County Electric Coop							
Residential ¢/kWh	9.64	9.36	8.48	8.44	7.57	7.86	-3.99
Commercial ¢/kWh	9.02	8.77	8.30	7.68	6.89	7.26	-4.24
Industrial ¢/kWh	10.06	7.93	7.24	7.94	7.48	7.86	-4.81
Residential Share %	0.2	0.2	0.2	0.2	0.2	0.2	
Commercial Share %	0.2	0.2	0.1	0.2	0.2	0.2	
Industrial Share %	0.0	0.0	0.1	0.0	0.0	0.0	

[illegible]

9. *Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources – utility ratepayers, utility shareholders or the highest bidder?*

If the policy were to eliminate the regulator's role in setting rates through traditional revenue requirements methods and to allow rates to be determined in the market, then such a policy is expected to benefit most ratepayers in the long run. In the short run it is possible that some rate payers may not see significant benefits from competition, depending upon the magnitude of stranded cost charges. Also, utility shareholders who have invested in utilities with substantial generation assets are likely to bear more risk. The degree of risk may depend upon the treatment of stranded costs and the utility's ability to compete in the market place.

To manage restructuring issues, states could establish study committees or working groups, which involve all stakeholders in the task of clarifying issues and identifying alternative approaches to issues. The goal would be to establish consensus on a restructuring plan that would meet the state's restructuring objectives.

In a competitive market, efficient resources allocations are determined by the market. Thus, the welfare of utility ratepayers and utility shareholders will be maximized through choices that are made by consumers and suppliers in the market. Regulators may need to retain oversight of markets that are not truly competitive. Otherwise, barriers could be erected to thwart competition and ratepayers could end up paying monopoly rents.

10. *Of those states which have adopted retail competition, how many have addressed the issue of "reciprocity", (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?*

The Arizona Corporation Commission considered a reciprocity requirement for participation in the competitive electric market, but is concerned that such requirements might violate the commerce clause of the federal constitution. This is a "fairness" issue rather than a competitive issue. That is, the lack of reciprocity affects the electric utilities but not necessarily the market.

11. *If Congress were to require "unbundling" of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?*

Last month, Arizona established an Unbundled Services and Standard Offer Working Group to consider how such an action might be implemented. We anticipate that within the next six months that we will have discussed and defined all the steps necessary to move to an unbundled services environment. Congress should consider the fact that other states will need a similar amount of time to prepare for "unbundling". If you chose to include a requirement for "unbundling", give the states and the utilities enough time to prepare properly for the "unbundling".

12. *Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?*

Salt River Project is a public power provider that has well over 600,000 customers in the metropolitan Phoenix area. The investor owned utilities maintain that SRP's preferences present an

“uneven playing field”. The quasi-proprietary/quasi-governmental structure of the Salt River Project presents many novel issues. The Arizona Corporation Commission and Salt River Project are attempting to solve these problems.

13. *How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems arise if it were not?*

Implementation of retail competition by federal act would impose unknown funding requirements on the Arizona Corporation Commission. Complicated or particularly detailed federal legislation on the order of the Telecommunications Act of 1996 would require greater staffing levels, while simpler legislation authorizing the states to proceed with retail competition, as Arizona is today, might not require any additional staffing levels.

14. *Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?*

The methods for computing and recovering stranded costs are presently being studied by subcommittees of the Stranded Cost Working Group. No definitive decisions have yet been reached. Accordingly, we are unable to provide any substantive response to this question at the present time.

15. *There is a wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the record level of merger activity, this question may become significant for all holding company activities.*
- a. *Do you believe PUHCA impedes competition, at the whole sale or retail level? Can “effective competition be achieved regardless of whether Congress enacts changes to PUHCA?*
 - b. *Do you believe Congress should modify or repeal PUHCA? If so, why, and under what if any conditions?*
 - c. *Should Congress enact legislation to modify the holding In Ohio Power Co. V. FERC. 954 F.2d 779 (D.C Cir. 1992)?*

PUHCA does not materially inhibit the implementation of competition at either the wholesale or retail level. Effectively competitive markets can exist, even without change to PUHCA. Congressional attention paid to PUHCA reform is a diversion from attention which should be paid to retail competition. Implementation of meaningful retail competition would make no modification of the holding of Ohio Power Co. V. FERC 954 F2.d 779 (D.C. Cir. 1992) less necessary, since the competitive market would tend to inhibit uneconomic affiliate transactions.